Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Haynes	Analyst:	Roger Lackey	Bill Number:	SB 654
Related Bills:	See Legislative History	Telephone:	845-3627	Amended Date:	04-16-2001
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Energy Conservation Percentage Refundable Credit

SUMMARY

This bill would allow a refundable credit for energy conservation.

SUMMARY OF AMENDMENTS

The April 16, 2001, amendments deleted the provisions of the bill regarding standby charges for electrical corporations. Instead, the amendment added the following:

- A requirement that each investor owned utility in this state provide its customers an itemized account of their energy consumption for the current year and the immediately preceding year.
- An income tax credit for a taxpayer's energy conservation savings.

These items are further discussed in <u>THIS BILL</u> below.

The department did not analyze the bill as introduced February 23, 2001.

PURPOSE OF THE BILL

The author's purpose for the bill is to encourage energy conservation by allowing a credit based on the amount the taxpayer reduces electricity usage from the prior year.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. The credit would be operative for taxable years beginning on or after January 1, 2001.

POSITION

Pending.

Summary of Suggested Amendments

Department staff is available to assist the author in resolving the considerations discussed below.

Board Position:			Department Director	Date
_____ S	_____ NA	_____ NP		
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ANALYSIS

FEDERAL/STATE LAW

Federal law currently provides two energy-related credits: an energy investment credit, and a business credit for the production of electricity from certain renewable resources.

The energy investment credit is equal to 10% of the basis of energy property placed in service during the taxable year. Energy property includes equipment that uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat. It also includes equipment that produces, distributes, or uses energy derived from geothermal deposits. The equipment also must meet performance and quality standards prescribed by federal regulations.

The business credit for the production of electricity from certain renewable resources is equal to 1.5 cents multiplied by the kilowatt hours produced by the taxpayer's qualified energy resource and facility. To qualify, the energy must be sold to an unrelated person during the taxable year. Qualified renewable energy resources include wind, closed-loop biomass, and poultry waste.

Prior federal law allowed a credit equal to 15%, up to a maximum total credit of $300, for the purchase and installation of energy-saving components in an individual's residence. The qualifying expenditures included such items as:

- energy efficient furnace burners and electrical or mechanical furnace ignition systems; and
- storm or thermal windows or doors, and caulking or weather-stripping of exterior doors or windows.

A separate federal credit equal to 40% of the costs, up to a maximum total credit of $4,000, was allowed for tax years 1979-1986. That credit was based on the purchase and installation of renewable energy equipment, such as solar energy systems, and wind and geothermal energy equipment. The renewable energy equipment was required to be installed in an individual's primary residence located in the United States. The equipment must have been new when installed and have had an expected useful life of at least five years.

Prior state law allowed two energy-related credits: an energy conservation credit equal to a percentage of the cost of energy conservation measures, and a solar energy credit also equal to a percentage of the cost of the solar energy system.

Current state law does not provide a credit for energy conservation.

THIS BILL

Under the Revenue and Taxation Code, this bill would allow a refundable credit for conserving energy. The credit would be equal to the cost paid or incurred by the taxpayer for electricity during the taxable year multiplied by the taxpayer's energy savings from the current taxable year compared to the immediately preceding taxable year. The savings would be expressed as a percentage.

“Energy conservation percentage” would mean the reduction in a taxpayer’s electricity usage for the current taxable year as compared to the immediately preceding taxable year. The reduction would be expressed as a percentage and could not exceed 25%.

Any credit amount that exceeds the taxpayer’s tax liability would be refunded to the taxpayer upon appropriation by the Legislature.

Under the Public Utilities Code, this bill would require investor-owned utility companies to provide, with a customer’s monthly billing statement, an itemized accounting of the taxpayer’s electricity consumption for the current taxable year and the immediately preceding taxable year. This accounting would allow the taxpayer to claim the energy conservation tax credit.

IMPLEMENTATION CONSIDERATIONS

This bill would require investor-owned utility companies to provide an itemized accounting of the taxpayer’s electricity consumption during a taxable year. However, not all utility companies are investor-owned. As a result, a number of taxpayers would not have the necessary information to determine their energy conservation percentage and the resulting credit.

It is unclear how the itemized accounting of the amount of electricity reduction would be reported. Utility companies do not normally have information concerning the beginning, end, or duration of, a customer’s taxable year. Consequently, utility companies would not have information needed to provide the information required by the bill. Uniform reporting by all utility companies may be necessary to ease the burden on utility companies to comply with the reporting requirement and the taxpayer’s burden of calculating the credit on their income tax return.

It is not clear how the credit is to be calculated either by using the amount (kilowatt hours) of electricity used by the taxpayer or the amount paid for the electricity. Given the ever-changing cost of electricity it would be difficult to determine an accurate amount of savings using the cost of the utilities.

Also, a number of taxpayers have installed or may install alternative energy sources. These energy sources would result in the taxpayer purchasing less electricity from a utility company. Utility companies subsidize many of these alternative energy sources. As a result, the taxpayer’s reduced use of electricity purchased from a utility is not solely due to the taxpayer’s efforts. Therefore, a portion of the credit would be for savings that were subsidized by the utility company.

This bill would compare the electricity usage of the current taxable year with the electricity usage of the immediately preceding taxable year. However, a number of taxpayers may have moved to the state during the current taxable year and would have no preceding year to compare. As a result, these taxpayers would have no recognized savings and would not be eligible for the credit even though these taxpayers are experiencing the same high electricity costs.

Although taxable years are normally 12 months, a taxable year may be less than 12 months. Taxpayers with a short preceding taxable year likely would not recognize savings in the current taxable year. It is unclear how a taxpayer would calculate the energy conservation percentage in such circumstances.

Conversely, taxpayers may have left the state during the taxable year and as a result shown a savings from the previous taxable year. These taxpayers would receive a large credit even though it was not as a result of actual savings.

A significant number of California residents are not required to file a California income tax return due to their income levels. These individuals may file a tax return to obtain the refundable credit, increasing the number of returns received and processed by the department.

This bill is unclear regarding how multiple taxpayers living in one residence would determine the credit. Each taxpayer would be eligible to claim the credit.

This bill would require regular appropriations by the Legislature to pay for the refundable portion of this credit. If sufficient funds were not appropriated to cover all of the refunds due, the department would suspend payment of the refunds until additional funds were appropriated. This delay would result in additional contacts to the department by refund recipients, which would likely increase departmental costs.

Since the proposed credit is refundable, the credit would need to be shown in the payment section on all personal income tax (PIT) returns except the Form 540 2EZ. This would increase PIT return Forms 540, 540NR, 540X, and potentially the 540A by one page.

Adding a page to these forms would result in a significant impact on FTB's operations and costs, would slow return processing, and would increase the amount of return storage space. The department would work within available space but may be required to lease additional office and file storage space.

Additional resources would be necessary to prevent the fraudulent filing of returns for the purpose of claiming the refundable credit.

LEGISLATIVE HISTORY

SBX 54 and SBXX 54 (Haynes) are the identical special session versions of this bill. SBX 54 died once the first special session was closed. SBXX 54 is currently at the Senate Desk.

ABX 27 and AB 1124 (Koretz, 2001/2002) would allow multiple credits and an accelerated depreciation deduction for the purchase of a power generation system. ABX 27 is in the Assembly Revenue and Taxation Committee, while AB 1124 is at the Assembly Desk.

ABX 15 (Rod Pacheco, 2001/2002) would allow a 100% credit for the purchase of energy conservation measures that reduce a taxpayer’s electricity and natural gas use by 5% from the previous taxable year and is in Assembly Revenue and Taxation Committee. ABX 86 and AB 1264 (Campbell, 2001/2002) would allow a 75% credit for the purchase and installation of a solar energy system for residential purposes. Both of these bills are at the Assembly Desk. SBX 17 (Brulte, 2001/2002) would allow a credit for the purchase and installation of a solar energy system for the production of electricity and is in Senate Revenue and Taxation Committee.

AB 873 (Takasugi, 1997/1998) would have allowed a credit equal to 40% of the cost of energy conservation measures. The bill also would have allowed a second credit equal to 10% of the cost of a solar energy system installed on premises located in California and used for commercial purposes, subject to certain requirements. The bill failed to pass the Assembly Revenue and Taxation Committee.

OTHER STATES' INFORMATION

Massachusetts: Currently has an energy credit that is equal to 15% of the net expenditures or $1,000, whichever is less.

New York: For personal income tax (PIT) only, New York allows a credit for solar generating equipment equal to 25% of certain solar generating expenditures. The credit is capped at $3,700 per system.

*Michigan***:** Does not allow an energy-related credit, but exempts the value of energy conservation devices from the local property tax.

Oregon: Currently has two energy credits: a PIT consumer energy purchases credit, and a corporate tax credit for the costs of energy projects. The consumer energy purchases credit allows various credits ranging from $50 to $1,500 for consumer purchases of certain items. The corporate credit for the costs of energy projects is a credit equal to 35% of the incremental costs of the project involving energy conservation and other related projects.

FISCAL IMPACT

The costs to implement this bill beginning in the 2001 Tax Year, 2002 process year, are estimated to be **$5.5 million, 126 personnel years (PYs) for Fiscal Year 2001-02** and **$4.3 million, 122 PYs for Fiscal Year 2002-03.**

This bill will need to be amended to add supplemental appropriations for FTB's Fiscal Year 2001-02 budget.

ECONOMIC IMPACT

Revenue Estimate

The revenue impact of this bill, under the assumptions discussed below, is estimated to be as follows:

Revenue Impact of SB 654 Taxable Years Beginning On or After 1/1/2001 Enactment Assumed After June 30, 2001 (In Millions)			
	2001-2	2002-3	2003-4
Revenue Impact	($1,000)	($800)	($500)

This analysis does not account for changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

The estimates are based on the following information. Currently there are several measures, proposed or in place, that aim at reducing energy consumption in the State. For example, the Governor's 20/20 program would give a 20% rebate on energy bills, if a consumer reduces his/her energy usage by 20% or more. There are also proposals, both by the Governor and the California Public Utilities Commission, to increase retail prices in 2001. These measures as well as the potential effect of this bill would cause reductions in energy usage in California in coming years.

Based on contacts with industry experts, the staff assumed a one-time system-average rate increase of 20% in 2001. It was assumed that without these measures electricity consumption would remain at the 2000 level. According to the estimates by the California Energy Commission, the electricity usage in 2000 by residential, industrial, commercial, and agricultural customers was 246,161 GWH. This resulted in a total electricity bill of about $24 billion for the year 2000. It was further assumed that all these energy conservation measures would result in a 5% reduction in energy usage in 2001, 3% in 2002, and 2% in 2003.

ARGUMENTS/POLICY CONCERNS

Historically, refundable credits, such as the former state renter's credit and the federal Earned Income Credit, have had significant problems with invalid and fraudulent returns. These problems are aggravated if a refund is made that is later determined to be fraudulent. In such cases the refund commonly cannot be recovered.

This bill does not contain a sunset date. Generally, credits contain a sunset date that allows the Legislature to review the credit for its effectiveness.

LEGISLATIVE STAFF CONTACT

Roger Lackey
Franchise Tax Board
845-3627

Brian Putler
Franchise Tax Board
845-6333